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April 28, 1997

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**via Hand Delivery**

Ms. Regina Keeney
Chief, Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W., Room 500
Washington, D.C. 20554

Re: SBC CEI Plan for Alarm Monitoring Service, CC Docket Nos. 85-229, 90-623 and 95-20 and SBC Application for In-Region InterLATA Authority, CC Docket No. 97-121

Dear Ms. Keeney:

On April 7, 1997, the Alarm Industry Communications Committee wrote the Commission to emphasize the importance of evaluating the compensation arrangements between SBC Communications, Inc. and its alarm monitoring marketing clients to ensure that the relationship is an arm's length one and not a prohibited joint offering which gives SBC an interest in the commercial success of the venture.[1/] AICC indicated the alarm industry standards by which the SBC-client compensation scheme should be measured.

On April 14, 1997, SBC responded by declining to provide the Commission with any information on its compensation plans and requesting quick action from the Commission.[2/] Without the information described by the AICC, however, the record in this inquiry is devoid of the evidence necessary for the Bureau to conclude that SBC will not have a stake in the commercial success of its alarm monitoring clients. SBC has mistakenly concluded that the "net

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[1/] Letter from Danny Adams, Counsel to AICC, to William F. Caton, Secretary, Federal Communications Commission, dated April 7, 1997.

[2/] Letter from Patricia Diaz Dennis, Senior V.P. and Assistant General Counsel, SBC, to William F. Caton, Secretary, Federal Communications Commission, dated April 14, 1997.

revenue" example of the *Second Report and Order* is the *only* means by which it can be found to have an impermissible interest.[3/] In fact, there are numerous such possibilities. As the Commission indicated in the *Second Report and Order*, "we will also consider how the BOC is being compensated for its [alarm marketing] services."[4/] If the record is closed at this time, as requested by SBC, the Bureau has not completed the analysis required by the Commission and has no basis upon which to conclude that SBC has met the test established by the *Second Report and Order*.

The importance of the Commission ruling on this matter was magnified on April 11, 1997, when SBC filed a Section 271 Application seeking authority to offer in-region interLATA services. That Application makes clear SBC's intention to circumvent the interLATA separate affiliate requirement of Section 272 through an exclusive "marketing" arrangement with its long-distance affiliate. SBC stated:

> SBLD and SWBT may also share directly administrative and other services, including marketing services . . . . To the extent SWBT provides these services to SBLD, *and to the extent that those shared services are non-marketing in nature*, SWBT will make them available on a non-discriminatory basis.
>
> SBLD and SWBT may each obtain administrative or joint marketing services from a common "services affiliate." If obtained from a common "services affiliate," . . . *any joint marketing services may be obtained on an exclusive basis*, regardless of whether they are obtained from a services affiliate or from SWBT.[5/]

Whatever marketing plan is permitted by the Commission in the alarm monitoring context, then, is certain to be used by SBC (and other RBOCs) as precedent for direct sales of in-region interLATA services as well.

SBC undoubtedly intends, as part of its plan to direct market its affiliate's in-region long-distance services on an exclusive basis, to be compensated through a revenue sharing arrangement like that used for alarm monitoring. If not structured properly, this arrangement could effectively nullify the separate affiliate requirements of Section 272. If also successful in its court challenge to the Commission's reading of Section 272(e)(4), SBC will be in a position to design and build an in-region network, sell retail services directly to end users, and share in the

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[3/] See *Telemessaging, Electronic Publishing and Alarm Monitoring Services*, CC Docket No. 96-152, *Second Report and Order*, FCC 97-101, released March 25, 1997, at ¶ 39.

[4/] Id.

[5/] Brief in Support of Application By SBC Communications Inc. for Provision of In-Region, InterLATA Services in Oklahoma, filed April 11, 1997, at 47-48.

resulting revenue, all outside the separate affiliate requirements of Section 272.[6] Obviously, the decision reached here on permissible financial arrangements for the marketing of alarm monitoring services has very significant ramifications for the manner in which SBC markets the in-region long-distance services of its affiliate as well. SBC would have the Bureau make this decision without any information on its compensation plans.

The reasons offered by SBC's April 14 letter for its refusal to provide additional information are entirely without merit. AICC does not seek rate regulation or anything resembling it. Rather, it merely points out the obvious -- whether or not SBC has a stake in the commercial success of the alarm monitoring venture depends entirely on the structure of its compensation arrangements. Some such plans are legally permissible under the *Second Report and Order* and others are not. Unless the FCC knows the facts of SBC's plan, the Commission cannot lawfully adjudge it acceptable.[7]

There are two key elements which are necessary for evaluation of the compensation scheme associated with SBC's marketing of prohibited alarm services. First, the Commission must know that the economic relationship between the alarm monitoring company and its end user customer is unencumbered by involvement of its marketing agent, SBC. The alarm provider must not be constrained from setting its own price to the end user, to raise or lower that price, to sell or transfer the Customer Contract to another alarm monitoring company, and to exercise all the indicia of ownership and control of its relations with its customer. Further, the contract between the alarm monitoring company and the customer must spell out the services provided and duties of each, including separate identification of the total monitoring service fee the customer is paying to the alarm monitoring company (separate and distinct from SBC's CPE or maintenance charges).

Second, if SBC is not obtaining an interest in the alarm company's commercial success, one would expect the compensation arrangement between SBC and the alarm monitoring company to be consistent with standard industry marketing and agency relationships. If the relationship is truly one of marketer-to-provider, with no joint venture aspects, SBC will not be able to command a significant premium over other alarm marketing agents. As AICC pointed out in its April 7 letter, the cost of sales and marketing of an alarm monitoring company rarely exceeds 25 percent of revenue.

It is important to understand, however, that in the alarm business, resale is common. Of approximately 14,000 alarm companies in the U.S., only about 2,000 actually operate alarm monitoring centers. The remaining 12,000 generally are resellers who are in the alarm monitoring business by virtue of subcontracting out for the alarm monitoring function. In those settings, the reseller takes responsibility for the customer relations functions, has the right to set prices or

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[6] *See* Bell Company Reply Comments on Expedited Reconsideration, CC Docket No. 96-149, filed April 24, 1997.

[7] SBC's claims of industry price fixing are absurd and will not be responded to by AICC.

transfer the account, accepts certain liabilities and so on, and, as a result, the reseller retains significantly more of the revenue stream (60-75 percent) from serving a customer, typically paying the monitoring subcontractor 25-40 percent of the customer's charges.

The difference in compensation between a reseller and a sales agent is derived primarily from the value of owning the customer contract for alarm monitoring services. A reseller, like any other alarm monitoring company, not only benefits from the cash-flow of the monthly monitoring fee as earned from month to month, but enjoys a growth in alarm monitoring company assets based upon the historical future value of the monthly fee which the customer contract represents. The customer contract establishes a right to receive future cash-flow and, therefore, is considered an asset. Any arrangement in which SBC receives compensation commensurate with control over the monitoring contract exceeds mere marketing and is more akin to resale than sales agency. Without a clear understanding of its compensation arrangement, the Commission cannot determine whether SBC is a marketing agent or a reseller.

Industry practice shows that a marketing relationship typically generates a 20-25 percent share of monitoring revenues, while a resale relationship will give the reseller 70-75 percent of the revenue. Obviously, resellers have a stake in the commercial success of their business and, in fact, are in the alarm monitoring business. If SBC can command compensation at reseller levels, it too should be presumed to be engaging in resale, which is prohibited by Section 275 and the *Second Report and Order*.

The Bureau should not be stampeded into making a decision on an incomplete record in this matter. The timing here is in SBC's control, not the Bureau's. When SBC provides the necessary information, which only it possesses, the Bureau will be in a position to act. Until then, however, it is impossible to evaluate SBC's plan. Forcing SBC to make proper disclosure is especially important here, where the decision will govern SBC's marketing of both alarm monitoring services and in-region interLATA offerings.

Sincerely,

Danny E. Adams

Danny E. Adams
Counsel to the Alarm Industry Communications Committee

cc: Claudia R. Pabo
Steve Teplitz